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Supreme Court, U.S.
FILED
JUL 25 2006
OFFICE OF THE CLERK

No. 05-1500

IN THE

Supreme Court of the United States

COUNTY OF LOS ANGELES,

Petitioner,

v.

NORTHROP GRUMMAN CORPORATION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE CALIFORNIA COURT OF APPEAL, SECOND APPELLATE DEPARTMENT

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

(1) Whether overhead property used by a federal contractor in the performance of government contracts, the costs of which are allocable in accordance with accepted accounting principles to such performance, may, consistent with applicable California and federal law, be subjected to California ad valorem property tax.

(2) Whether such overhead property, pursuant to § 52-232-16(d) of the Federal Acquisition Regulations (48 CFR § 52.232-16) becomes property of the United States Government.

CORPORATE DISCLOSURE STATEMENT

Respondent Northrop Grumman Corporation, a Delaware corporation, has no parent corporation, nor is there any publicly held company which owns 10% or more of Northrop Grumman Corporation's stock.

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STATEMENT OF THE CASE

This is a tax refund action brought by Respondent with respect to property taxes levied by Petitioner on tangible personal property, such as perishable tools, equipment, supplies and technical books,[1] procured and used by Respondent in the performance of its contracts with the federal government. Respondent is a contractor which designs and manufactures aircraft and aircraft components under contracts with both the United States Government ("Government") and private commercial customers. During the tax years 1987 to 1995 Respondent designed and manufactured both military aircraft, such as the B-2 Stealth Bomber and the F-18 fighter, and commercial aircraft, such as the fuselage assembly of the Boeing 747 airliner, at plants

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1. Perishable tools include abrasive bands, bolts, cloths, disks, spiral points, adapters, anodic racks, batteries, bits, brushes, clamps, cleaners, counter sinks, drills, extractors, fasteners, files, gauges, hammers, mallets, plyers, punchers, reamers, wrenches and the similar. ¶4, Stip. Of Facts. Minor equipment includes office equipment, machinery and equipment, and factory equipment used in the performance of Respondent's contracts. *Id.* at ¶5. Supplies include material and supplies on hand that do not directly enter into finished products but are necessary for day-to-day administrative and production efforts, such as office supplies, drafting room supplies, safety equipment, paints, chemicals, oils, acids, adhesives, gloves and common production supplies such as nuts, bolts, screws and nails. *Id.* at ¶6. Technical books include publications commonly published by governmental or aerospace industry organizations which contain general or specific information used or referred to by Respondent in its performance of contracts, such as material specifications (strength, stress or wear tolerance), government or industry standards for aeronautical or radar design or manufacture, industry standards or procedures for material fastening and the similar. *Id.* at ¶7

located in Los Angeles County. Each of Respondent's Government contracts incorporated the "progress payment" clause of § 52.232-16 of the Federal Acquisition Regulations (48 C.F.R. § 52.232-16). This clause, in turn, included the "progress payment title clause" (found at subdivision (d) thereof), which transferred title in property allocable to contract performance, to the Government. Respondent contends, and the court below found, that pursuant to this title clause the portion of the subject perishable tools, equipment, supplies and technical books allocable in accordance with generally accepted accounting principles to the performance of contracts between Respondent and the Government (hereinafter "the Property"), was owned by the Government, and thus not taxable.[2] Petitioner, in contrast, asserts (i) that the progress payment clause passed only a security interest, and not title, to the Government; (ii) that in any case the Government's interest, whether ownership or security, inhered only in property directly charged to a particular Government contract (not the indirectly charged, or "overhead" property, at issue herein); and (iii) that irrespective of title, Respondent was subject to tax based upon its beneficial possession or control of the Property under California *Revenue and Taxation Code* § 405.

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2. Respondent contends that the tax was improper both because Respondent did now own the property so as to be taxable thereon, and because the federal government's property interest is constitutionally immune from taxation. *United States et al. v. Allegheny County*, 322 U.S. 174, 176-177; 64 S. Ct. 908, 910-911; 88 L. Ed. 1209, 1213-1214 (1994).

REASONS FOR DENYING THE PETITION

Certiorari should be denied in this matter for each of the following reasons:

1. The great weight of the law plainly supports both (i) that the progress payment title clause passes title, and not just a lien, to the federal Government; and (ii) that such title passage operates equally with respect to both direct and indirect property, allocated to contract performance.

2. The Petition raises no substantial federal issue because (i) the taxability of the Property below ultimately turned on state rather than federal law; and (ii) in any case, a state court's construction of the progress payment title clause in state tax litigation imports negligible impact on federal law or interests.

3. The decision below does not conflict with any decision of this Court, or of a United States Court of Appeals; and

4. Petitioner has not otherwise met its burden of demonstrating "compelling reasons" for the grant of certiorari. (Sup. Ct. R. 10)

ARGUMENT

I. The California Appellate Court Correctly Found That The Progress Payment Clause Passed Title, And Not A Mere Lien, To The Federal Government.

The progress payment title clause (48 C.F.R. § 52.232-16) reads in relevant part as follows:

> (d) *Title.* (1) Title to the property described in this paragraph (d) shall vest in the Government. Vestiture shall be immediately upon the date of this contract, for property acquired or produced before that date. Otherwise, vestiture shall occur when the property is or should have been allocable or properly chargeable to this contract.
>
> (2) 'Property,' as used in this clause, includes all of the below-described items acquired or produced by the Contractor that are or should be allocable or property chargeable to this contract under sound and generally accepted accounting principles and practices.
>
> (i) Parts, materials, inventories, and work in process;
>
> (ii) Special tooling and special test equipment to which the Government is to acquire title under any other clause of this contract;
>
> (iii) Nondurable (i.e. noncapital) tools, jigs, dyes, fixtures, molds, patterns, taps, gauges, test equipment and other similar manufacturing aids, title to which would not be obtained as special tooling under subparagraph (ii) above; and

> (iv) Drawings and technical data, to the extent the Contractor or subcontractors are required to deliver them to the Government by other clauses of this contract."

48 C.F.R. § 52.232-16(d).

The intent of the progress payment title clause to vest title, and not just a lien , in the Government is plain on the face of the regulation. *Id.* That the Government intends to take title to its contractors' property in exchange for progress payments, is also long supported in the federal case law. *United States vs. Ansonia Brass & Copper Co.* (1910) 218 U.S. 452, 466-467; 81 S. Ct. 49, 52-53; 54 L. Ed. 1107, 1113. *In Re American Boiler Works* (3d Cir. 1955) 220 F.2d 319, 320-321. *Shepard Engineering Company vs. United States* (8th Cir. 1961) 287 F.2d 737, 741.

In the *American Boiler Works* case the court plainly stated:

> "But one does not need a citation of decided cases to understand the language above quoted in Article 3 of the contract between the parties. It is as clear as English words can make it. The title, both to the vessels and to the materials, vested in the government with no ifs, ands or buts. And without any mention of payment as a prerequisite thereto.

In Re American Boiler Works, supra, 220 F.2d at 320-321.

The 1982 decision of the Court of Claims in *Marine Midland Bank vs. United States* (Ct. Cl. 1982) 687 F.2d 395; 231 Ct. Cl. 496 that the progress payment clause creates only a security interest constitutes a distinct minority of one. In addition to the above authorities to the contrary, all decisions after *Marine Midland* have also disagreed with, and declined to follow, its holding. *In Re American Pouch Foods, Inc.* (7th Cir. 1985) 769 F.2d 1190, 1193-1196, *cert. denied*, 475 U.S. 1082; 106 S. Ct. 1459; *First National Bank of Geneva vs. United States* (Ct. Cl. 1987) 13 Cl. Ct. 385, 387; *In Re: Verco Industries* (1982, BAP, 9th Cir.) 27 B.R. 615, 619-620; *In Matter of Double H Products* (1972, 3d Cir.) 462 F.2d 52, 54-55; *Hughes Aircraft Company vs. County of Orange* (2002) 96 Cal. App. 4th 540, 557-558, 117 Cal. Rptr. 2d 601, 614; *Strayhorn, Comptroller vs. Raytheon E Systems* (2003) 101 S.W.3d 558, 569-570; *Motorola Inc. vs. Arizona Dept. Of Revenue* (1999) 196 Ariz. 137, 144; 993 P.2d 1101, 1108; *McDonnell Douglas vs. Director of Revenue* (1997) 945 S.W.2d 437, 440-441.

That the progress payment title clause passes title, and not just a lien, was also strongly confirmed by Congress' enactment in 1997 of subdivision (h) of 10 U.S.C. § 2307, as follows:

> (h) Vesting of title in the United States. If a contract paid by a method authorized under subsection (a)(1) [includes progress payments] provides for title to property to vest in the United States, the title to the property shall vest in accordance with the terms of the contract, regardless of any security interest in the property that is asserted before or after the contract is entered into.

10 U.S.C. § 2307(h) [bracketed language added].

Finally, in addition to the forgoing regulatory, statutory and case law, the Department of Defense's administrative construction of the progress payment clause is decidedly that the Government's interest is one of ownership, and not a mere lien:

> The Department of Defense, General Services Administration, and National Aeronautics and Space Administration have decided to withdraw six proposed rules. These rules appeared between 1989 and 1992 and have subsequently been determined to be unnecessary, incorporated into other rules, or need further review.
>
> * * *
>
> **FAR Case 89-11, Title to Property Under the Progress Payment Clause.**
>
> The proposed rule, published May 1, 1989 in the Federal Register (54 FR18631), is hereby withdrawn, as agreed by the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council. The proposed FAR clarifications published for public comment have been determined to be unnecessary because the current FAR adequately covers issues addressed by the proposed rule. The rule proposed a change to the progress payments clause of FAR 52.232-16. The Councils published the proposed rule to assist in assessing whether the FAR should be revised to emphasize that it is and always has been the intent of the FAR that the interest taken by the Government in property covered by the clause

> is title in the form of ownership, and not a mere lien. The Councils have determined that there is no need to clarify the intent of the FAR. Contracts containing the Progress Payments Clause clearly reflect the intention of the parties to grant title to the property to the Government and not grant merely a lien.

59 Federal Register 5750-5751, Federal Acquisition Regulation, Withdrawal of Proposals, FAR Case 89-11.

Thus, it is apparent that each of (i) the clear language of the progress payment clause itself, (ii) the overwhelming weight of case and statutory law; and (iii) contemporaneous administrative construction by the Department of Defense[3], unequivocally support the progress payment clause's passage of title, and not a mere lien, to the Government.

II. The California Appellate Court Correctly Found That The Progress Payment Title Clause Transfers Title To Both Indirect And Direct Property.

Direct property is property the costs of which are directly charged to a single Government contract. 48 C.F.R. § 31.202(a). Indirect property is property the costs of which are indirectly charged across multiple contracts, Government or otherwise, in accordance with accepted accounting

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3. It is well settled that the construction of a statute by those charged with its execution should be followed absent compelling indication that it is wrong, and particularly where the same construction is ratified by subsequent positive Congressional action as in this case. *Red Lion Broadcasting vs. FCC* (1969) 395 U.S. 367, 381-382; 89 S. Ct. 1794, 1801-1802; 23 L. Ed. 371, 383-384.

principles. 48 CFR 31.203.[4] The types of Property at issue herein are indirect property, having been both incurred and employed in common, in the performance of both Government and commercial contracts.

It is clear from the language of the progress payment title clause itself, that the clause comprehends both direct and indirect property. It broadly references "materials" and "inventories" used in contract performance, as well as specifically enumerated shop sundries such as "nondurable (i.e. noncapital) tools, jigs, dyes, fixtures, molds, patterns . . . and other similar manufacturing aids" which were "allocable or properly chargeable to this contract under sound and generally accepted accounting principles." 48 C.F.R. § 52.232-16(d)(2). The Property in this case, stipulated to be both non-capital and properly allocated to the performance of Government contracts, and consisting of items fitting both the general and specific descriptions of the clause [Stip. of Facts, ¶4, 5, 6,7 & 9], plainly falls within the purview of the progress payment title clause.

Multiple state courts have, consistent with the California appellate court herein, directly addressed this issue and confirmed that the progress payment title clause passes title in "overhead" property to the Government for state tax purposes. In *Aerospace Corporation vs. State Board of Equalization* (1990) 218 Cal. App. 3d 1300; 267 Cal. Rptr. 685, bulk supplies and equipment very similar to those at issue herein (such as batteries, resistors, raw metals or plastics, perishable tools and janitorial or office supplies

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4. These accounting principles, entitled "Cost Accounting Standards" are detailed at Parts 30 and 31 of the Federal Acquisition Regulations, including but not limited to 48 C.F.R. § 31.203.

[*Id.* at 218 Cal. App. 3d at 1304 n.1 and 267 Cal. Rptr. at 687 n.1], were found properly allocable to contract performance, and thus owned by the Government:

> Aerospace's allocation of overhead materials to specific contracts based upon direct labor performed on each contract is a reasonable method of allocation which conforms to government regulations and generally accepted accounting principles. Under the provisions of the fixed price contracts at issue, title to that portion of the overhead property allocated to such contracts by Aerospace vested in the federal government upon allocation.

Id.

Precisely in accord with *Aerospace* are each of the cases of *Hughes Aircraft, supra*, 96 Cal. App. 4th 540, 550-552; 117 Cal. Rptr. 601, 608-610; (overhead property used in performing the fixed price Government contract was transferred to the Government and thus not subject to property tax); *Motorola, Inc. vs. Arizona Department of Revenue* (1999) 196 Ariz. 137, 139 and 143-144; (even materials consumed in the mental work that underpins the physical manufacturing work are transferred to the Government, such that a resale exemption from use tax applied); *Strayhorn, Comptroller of Texas vs. Raytheon E-Systems, Inc., supra*, 101 S.W.3d 558, 566-567 (title in overhead property consumed in performing Government contracts and charged as an indirect cost passes to the Government); *McDonnell Douglas Corporation vs. Director of Revenue, supra*, 945 S.W.2d at 439-441 (since contractor's overhead property was transferred to the Government pursuant to the progress

payment title clause the "resale" exemption from sales tax applied.)[5]

In summary, though the federal courts have not directly addressed the issue, each of (i) the plain descriptive language contained within the progress payment clause itself, and (ii) the great weight of well reasoned state court authority, strongly support the California appellate court's decision below, i.e., that title to the overhead Property at issue herein, stipulated by the parties to have been properly allocated to the performance of Government contracts, passed to the Government.

III. This Case Does Not Raise A Substantial Federal Question.

In addition to having been correctly decided below, it is clear that the issues of this case, as well as those in the similar previous state court decisions, bear heavily upon the application and construction of *state* tax statutes, and little upon federal law or interests. Although Respondent believes strongly that the cited state court cases (other than the aberrant *TRW* decision) correctly interpret the progress payment title clause to include overhead property, it is also indisputable that such cases would not bind in any respect the federal courts or agencies such as to import a substantial federal question herein. Finally, although Petitioner attempts

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5. Although the lone case of *TRW Space and Defense Sector vs. County of Los Angeles* (1996) 50 Cal. App. 4th 1703, 1717-1719; 58 Cal. Rptr. 602, 611-612 holds to the contrary, i.e. that the title clause does not pass title to overhead property, same has been roundly criticized in both *Motorola, supra*, 196 Ariz. at 142-145; 993 P.2d at 1106 and *Hughes Aircraft, supra*, 96 Cal. App. 4th at 550-557; 117 Cal. Rptr. at 608-614, and otherwise disregarded.

mightily to frame this case as one touching upon the scope of the Government's constitutional immunity from state taxation, this issue actually does not arise at all herein, as will now be discussed.

A. No Issue of Federal Immunity Arises Because The Subject Property Is Non-Taxable On Purely State Law Grounds.

Under each of Petitioner's and Respondent's factual constructions, Respondent admittedly enjoyed a valuable possessory interest in the Property, which Respondent possessed and used during its performance of its Government contracts. It is also undisputed that the value of a third party's possessory interest in Government property may constitutionally be subjected to state property tax, i.e. is not protected by the Government's immunity. *United States, et al. vs. County of Fresno* (1977) 429 U.S. 452, 462-464; 97 S. Ct. 699, 704-705; 50 L. Ed. 683, 692-693. *City of Detroit, et al. vs. Murray Corporation of America, et al.* (1958) 355 U.S. 489, 492-493; 78 S. Ct. 458, 459-461; 2 L. Ed. 441, 445-446. Thus, Respondent does not dispute that it held a potentially taxable (non-immune) possessory interest in the Property. However, this by no means raises an issue of Governmental immunity in this case, since it is also well settled that California law chooses not to impose tax on possessory interests in personal property. *See General Dynamics Corp. vs. County of Los Angeles* (1958) 51 Cal. 2d 59, 63-65; 330 P. 2d 794, 795-797; *TRW Space & Defense, supra*, 50 Cal. App. 4th at 1712-1714; 58 Cal. Rptr. 2d at 607-608.

In summary, Petitioner raises no substantial federal question herein, whether of federal immunity or otherwise. Not only did the California appellate court in this case correctly find that the federal progress payment title clause passed title to the overhead property, but even an incorrect state court construction of the title clause, in a state tax case, would have plainly negligible impact on the federal agencies or courts. Finally, the taxability of the Property in this case did not turn on a question of federal immunity, but rather, in the final analysis, on California's own legislative determination not to tax possessory interests in personal property. *Id.*

IV. The Decision Below Does Not Conflict With Any Decision Of This Court Or Of The United States Court Of Appeal.

The California appellate court decision below does not conflict with any decision of this Court, nor of its subordinate Courts of Appeal. The only potentially conflicting federal decision is that in *Marine Midland Bank vs. United States*, *supra*, 687 F.2d 395, a Claims Court case which stands alone in holding that the progress payment title clause passes a lien, and not title. However, its holding is directly contrary to an otherwise unanimous contrary body of law, and has not been followed by subsequent courts. *In Re American Pouch Foods, Inc.*, *supra*, 769 F.2d 1190, 1195-1196; *First National Bank of Geneva vs. United States*, *supra*, 13 Cl. Ct. at 387.

CONCLUSION

It is plain that this case is not certworthy. The Petition should be denied for each of the reasons that (i) the California appellate court correctly construed the applicable federal regulation, (ii) no substantial federal question, or split in federal legal authorities, is raised in the case, and (iii) the decision below as to the taxability of the Property is amply supported on independent state law grounds. Petitioner simply has not met its burden of demonstrating the required "compelling reasons" for the grant of certiorari.

Respectfully submitted,

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